

Audit Brief – Use of Funds (East Hollywood High)

Objective and Scope:

As approved by the Utah State Board of Education, the Internal Audit Department (IA) performed an audit of the use of funds for state fiscal year 2016 at a selection of three local education agencies (LEAs), based on risk. Financial, compliance, and performance aspects were subject to consideration during the audit. Reports are being released by LEA to facilitate timely and effective communication and corrective action.

Findings and Observations:

Findings were identified in the following areas and are listed below with recommendations for corrective action. Findings are prioritized by significance. Observations are considered less significant than findings.

Finding areas:

- Internal Controls
 - Inadequate policies and procedures
 - Override of internal controls
 - Lack of segregation of duties
- Compliance with State and Local Procurement Regulations
 - For 39 transactions reviewed:
 - Lack of competitive procurement (e.g., obtaining required quotes, bids, etc.) for over \$140,000 related to 12 transactions
 - Lack of documentation for approximately \$1,100 of purchases related to 5 transactions
- Payroll Processing
 - Two checks, totaling approximately \$850 were issued for contracted staff wages without being subjected to payroll taxes.

Observations areas:

- Prudent Use of Funds
 - Use of over \$2,600 in taxpayer funds for questionable activities, including food for staff, decorations, and restaurants.

Cause:

Potential reasons for the findings include, a lack of governance, management, and/or internal control activities, including staff training.

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Effect:

The impact of the concerns varies, but there is an increased risk of fraud, waste and abuse of taxpayer dollars for public education, which may reduce assets and resources available to support enhanced student outcomes. Inability to show transparency, consistency, and value-obtained from purchases is also a significant risk. Inaccurate employee pay reporting potentially resulting in tax fines and/or fees was also identified.

Internal Audit Recommendations:

Ensure existing policies, procedures, and internal controls are comprehensive and operating effectively; as necessary, design, implement, and monitor new policies, procedures, and internal controls. Additionally, staff should be trained on policies, procedures, and internal controls regularly.

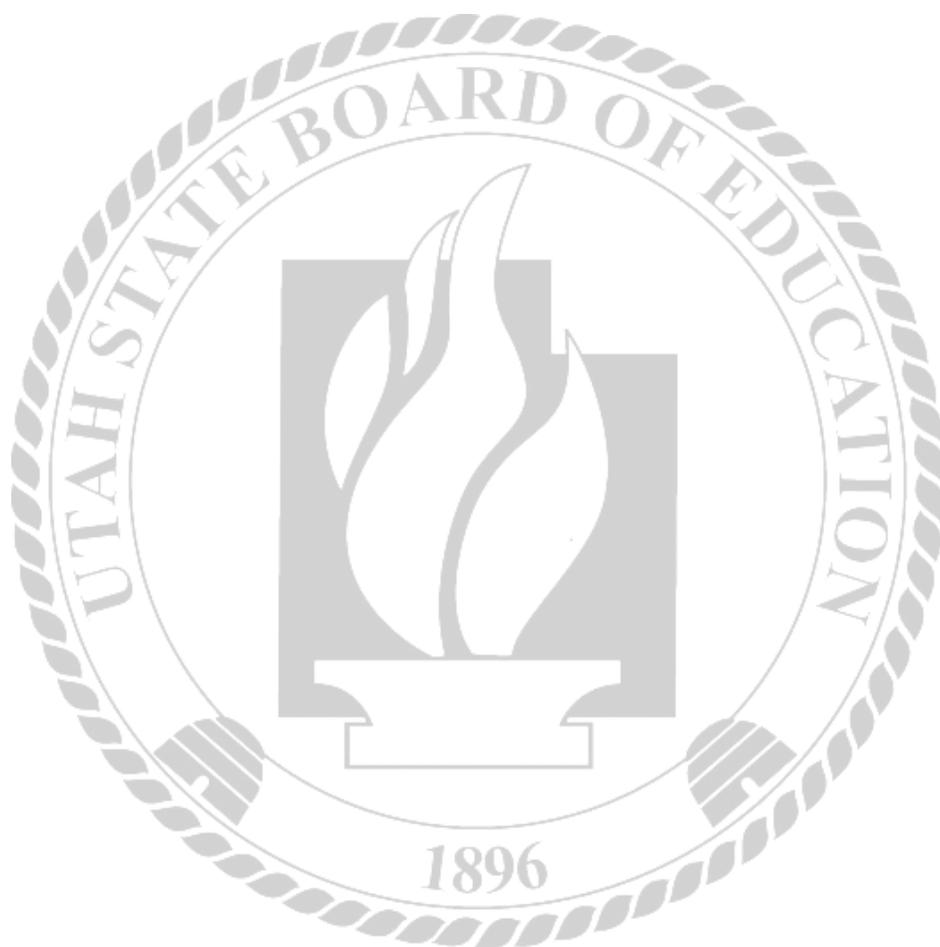
Management Response:

The LEA agrees with the findings and recommendations and has already made significant changes to internal controls and procurement policies and processes.

Utah State Board of Education

17-02

EAST HOLLYWOOD HIGH SCHOOL



USBE Internal Audit Department

07/14/2017

Board of Trustees
East Hollywood High School
2185 S. 3600 W.
West Valley City, UT 84119

Dear President Francone and East Hollywood High School Board Members,

The Utah State Board of Education (Board) Administrative Rule 277-116-3 authorizes the Board's Internal Audit Department (IA) to perform audits as outlined in the audit plan approved by the Board. IA performed an audit of East Hollywood High School's (LEA) use of funds for the purpose of verifying compliance with applicable code, rule, and policy and procedures. IA obtained relevant documentation from LEA personnel and performed the procedures below.

1. Gained an understanding, through research and inquiry, of applicable state code, administrative rule, and LEA policies.
2. Reviewed and analyzed, on a limited basis, the LEA's internal control environment.
3. Analyzed the LEA's disbursement of funds and documentation of disbursements.

These procedures were limited to fiscal records for state fiscal year 2016 (07/01/2015-06/30/2016). We have identified the procedures performed above and the findings, observations, and recommendations from those procedures are included in this report. These procedures were more limited than would be necessary to express an audit opinion on compliance or the effectiveness of internal control or any part thereof; accordingly, we do not express such opinions.

Audits are conducted in accordance with current International Standards for the Professional Practice of Internal Auditing.

By its nature this report focuses on exceptions, weaknesses, and problems. This focus should not be understood to mean there are not various strengths and accomplishments. We appreciate the courtesy and assistance extended to us by the personnel of the LEA during the course of the audit. Management's response to the audit is included as Appendix A.

This report is intended solely for the information and use of the LEA Board of Education and management of the LEA, and the Utah State Board of Education; it is not intended to be, and should not be, used by anyone other than these specified parties. If you have any questions, please contact me at (801) 538-7639.

Sincerely,

A handwritten signature in black ink that reads "Deborah Davis". The signature is written in a cursive style with a large initial 'D'.

Deborah Davis, CPA
Internal Audit Director, Utah State Board of Education

cc. Members of the Utah State Board of Education
Members of the Utah State Charter School Board
Sydney Dickson, Ph.D., State Superintendent of Public Instruction, Utah State
Board of Education
Katrina Walker, Director, East Hollywood High School
Ryan Marchant, Director, East Hollywood High School

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I. Background, Objective, and Scope

In the February 10, 2017 Utah State Board of Education meeting the board approved an audit of LEA (local education agency) use of funds. Three LEAs were selected for the audit, this report outlines the findings specific to one (East Hollywood High School) of the three LEAs reviewed.

East Hollywood High School's mission is to "provide authentic career preparatory training to students with a passion for careers in film production, digital media production, and acting." According to East Hollywood's financial statement for state fiscal year 2016, they received approximately \$2.5 million dollars of revenue and had a fall enrollment of 337 students.

The Internal Audit Department's (IA) objective was to consider potential fraud, waste, and abuse, appropriate handling of public funds, and to verify compliance with applicable state code, administrative rules, and policies and procedures. We reviewed relevant LEA financial records and other documentation as necessary. The scope of our audit covered records from fiscal year 2016.

II. Findings and Recommendations

Findings were identified in the areas listed below with recommendations for corrective action. Per auditor judgement, findings are prioritized by significance and are considered more significant than observations. Findings consists of five elements. The five elements are:

1. **Criteria:** What should happen (e.g., code, statute, best practices)?
2. **Condition:** What is happening?
3. **Cause:** Why did the condition happen?
4. **Effect:** What is the impact, or why should you care?
5. **Recommendation:** Suggestions on how to resolve the cause.

a. Internal Control

Criteria: East Hollywood High School Fiscal Policies & Procedures Guide, 100 Internal Control Policies states:

East Hollywood High, under the direction of the Board of Trustees, is required to establish and maintain adequate accounting records and internal control procedures. Internal controls consists of five components: control environment, risk assessment, control activities, information and communication, and monitoring.

GAO-14-704G Standards for Internal Controls in the Federal Government (best practice) states:

OV1.03 Internal control comprises of the plans, methods, policies, and procedures used to fulfill the mission, strategic plan, goals, and objectives of the entity. Internal control serves as the first line defense in safeguarding assets. In short, internal control helps managers achieve desired results through effective stewardship of public resources.

FIACCT 20-00.00 [State of Utah] Internal Control Program Policy (best practice) states:

- A. Agencies must establish and maintain sound internal controls based on the five components of internal control.
- B. Agencies must establish and maintain proper segregation of duties.

The policy further defines internal control activities as, “the policies and procedures that help ensure management directives are carried out. They help to ensure that necessary actions are taken to address risks to achievement of the entity’s objectives. They include a range of activities as diverse as approvals, verifications, reconciliations, security of assets and segregation of duties.”

Condition: The LEA lacks specific and comprehensive internal control activities, examples are outlined below.

- I. Inadequate policies and procedures
 - a. The LEA’s policy regarding the opening of mail allows for a single individual to open and document mail.
 - b. The LEA’s documented purchasing thresholds inadequately address annual cumulative thresholds, individual procurement thresholds, and/or single procurement aggregate thresholds for purchase amounts.
- II. Override of controls
 - a. Management did not adhere to the established pre-approval policy/procedure; instead, management and staff pursued procurements without obtaining and/or documenting approvals.
 - b. Staff other than the business manager prepared checks, which is contrary to local policies.
 - c. Management paid and/or reimbursed themselves and vendors without first obtaining proper documentation. See *b. Procurement* for additional details.
- III. Lack of segregation of duties
 - a. Staff with access to the general ledger received and opened mail.
 - b. Management who approve procurements, collect documentation, prepare disbursements, approve disbursements, sign payments, and send payments.

- c. Additional personnel who approve procurements, collect and retain documentation, destroy fiscal records, prepare disbursements, approve disbursements, and reconcile bank statements.

Cause: Lack of governance and management.

Effect: Potential fraud, waste, and abuse of public education funds, which may reduce assets and resources available to support enhanced student outcomes, poses a significant risk. Potential inability to accurately report financial results, which may lead to a loss of stakeholder confidence and have an adverse effect on obtaining future funding is also a significant risk. See conditions in *b. Procurement* for other specific effects of weak internal control activities.

Recommendation: The LEA board and administration should ensure an effective internal control environment by designing and implementing specific and comprehensive policies, procedures, and internal controls to safeguard public funds and assets and protect employees. Segregation of duties, or alternative controls if duties cannot be segregated given the size of the organization, should be of paramount consideration when designing internal controls. The LEA board and administration should also regularly monitor internal controls for operating effectiveness, revising them if needed.

b. Procurement

Criteria: East Hollywood High School, Procurement and Purchasing Policy, Required Approval/Purchasing Process states:

Step 2: Legal Requirements

2. Over \$1000, up to \$50,000: Must obtain two quotes, with the purchase from “the responsible vendor offering the lowest quote meeting specifications”
3. Over \$50,000: Most likely must conduct a formal bidding process (RFP) consistent with applicable law.

Utah Code Annotated 63G-6a-2002 Records—Retention states:

- (1) All procurement records shall be retained and disposed of in accordance with Title 63G, Chapter 2, Government Records Access and Management Act.
- (2) Written determinations required by this chapter shall be retained in the appropriate official contract file of:
 - (a) the division;
 - (b) the procurement unit with independent procurement authority; or
 - (c) for a legislative procurement unit or a judicial procurement unit, the person designated by rule made by the applicable rulemaking authority.

- (3) A procurement unit shall keep, and make available to the public, upon request, written records of procurements for which an expenditure of \$50 or more is made, for the longer of:
 - (a) six years;
 - (b) the time otherwise required by law; or
 - (c) the time period provided by rule made by the applicable rulemaking authority.
- (4) The written record described in Subsection (3) shall include:
 - (a) the name of the provider from whom the procurement was made;
 - (b) a description of the procurement item;
 - (c) the date of the procurement; and
 - (d) the expenditure made for the procurement.

Condition: Out of 39 transactions we noted the following concerns related to compliance with an applicable state and/or local regulation regarding procurement.

- Eleven out of 15 (73%) transactions reviewed for required quotes for a purchase per the LEA's policies did not obtain the requisite number of quotes; questioned transactions total \$53,784.03.
- One out of one (100%) transaction reviewed that required public notice and a request for proposal (RFP) process per the LEA's policies, did not comply with applicable criteria; the questioned transaction totals \$91,244.54.
- Five out of 39 (13%) transactions reviewed for required documentation, lacked adequate documentation. One of the transactions was a duplicate payment in the amount of \$114.97, which was paid to an employee. The transactions in question total \$1,118.47.

Cause: Lack of comprehensive internal control activities governing the procurement process. Limited management and staff procurement training is also likely a factor. See conditions in *a. Internal Control* for specific causes.

Effect: Potential fraud, waste, and abuse of public education funds, which may reduce assets and resources available to support enhanced student outcomes, poses a significant risk. Inability to show transparency, consistency, and value-obtained in financial transactions, which may lead to a loss of stakeholder confidence and have an adverse effect on obtaining future public education funding, is also a significant risk.

Recommendation: See the recommendation for finding *a. Internal Controls*; the LEA should consider all procurement methods when designing and implementing comprehensive and consistent policies, procedures, and internal controls. Additionally, LEA management, under the direction of the LEA board, should take action to recoup the \$114.97 duplicate payment to staff.

c. Payroll Processing

Criteria: East Hollywood High Procurement and Purchasing Policy, 601 Payroll Policy states:

(E) All payroll taxes and benefits are properly calculated and any deposits made in a timely manner.

Condition: Over the course of two months, one employee's pay was shorted \$859.50 when compared with their employment contract. To correct the oversight and pay the employee, the LEA issued two checks to the employee; however, neither check was processed through the payroll system.

Cause: Lack of internal controls to ensure employee compensation is properly calculated, documented, and paid.

Effect: Inaccurate employee payment records, which potentially could result in tax fines or fees.

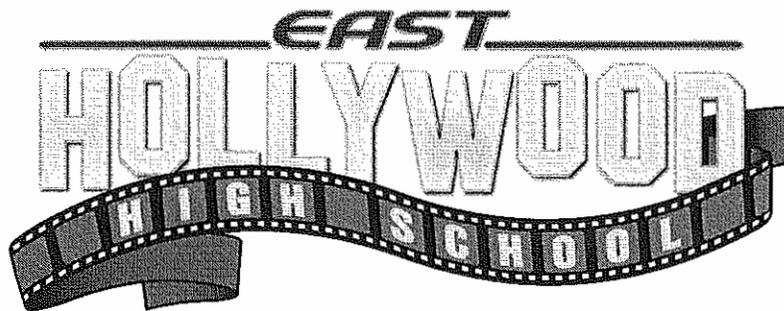
Recommendation: LEA management should develop and implement internal controls to ensure all employee wages are properly processed through the payroll system, which ensures payroll taxes are appropriately calculated, documented and paid.

III. Observations

a. Prudent Use of Funds

We identified five transactions, totaling \$2,605.28, where public funds were spent on various questionable activities, including food for staff, decorations, and restaurants. Due to the limited nature of public funds and the heightened scrutiny of their use, we question whether the use of public funds for these types of activities is considered prudent and necessary.

Appendix A



2185 S 3600 W
WVC, UT 84119
June 8, 2017

USBE Internal Audit:

Dear: Deborah

Enclosed are our Responses to your audit letter dated June 1, 2017 where three findings were noted and detailed.

A. Internal Controls.

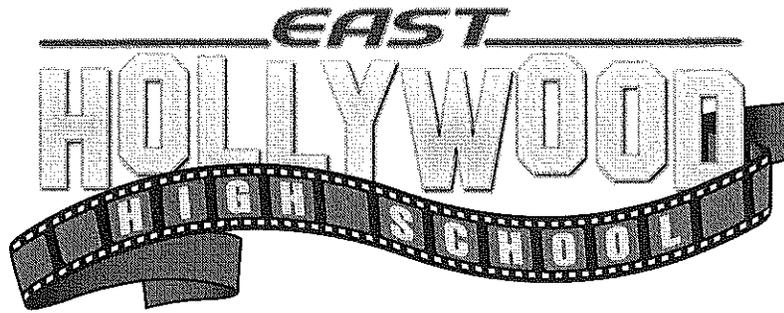
EHHS Response:

East Hollywood agrees with the findings and recommendations. East Hollywood has already made significant changes to our internal controls during this process and will continue to make the necessary changes as recommended. EHHS is currently in the process of reviewing and rewriting financial policy and procedures that will protect and safe guard the assets of the school.

B. Procurement.

EHHS Response:

East Hollywood agrees with the findings and recommendations. East Hollywood has already made significant changes to our procurement processes and will continue to make the necessary changes as recommended. As is the case with internal controls, EHHS is currently in the process of reviewing and making the necessary changes to our procurement policy that will provide for fair purchasing practices as well as protect and safe guard the assets of the school.



C. Payroll Processing.

EHHS Response:

East Hollywood agrees with the findings and recommendations. EHHS has made the necessary changes as recommended.

East Hollywood High School is grateful for this audit and feels it has already made us a better, more efficient organization. We would like to thank the internal audit staff for the professional and respectful manner in which the audit was conducted. As you are aware EHHS is a small organization where administrators wear many hats and perform many different duties throughout the day. Having said that, EHHS views this report as a catalyst to making the necessary corrections recommended, so we are in compliance with our policy and procedures.

If there are any additional questions or concerns you would like to discuss in more detail please feel free to contact the EHHS administration.

Sincerely,

Ryan Marchant

Director, EHHS

Skip Francone

President, EHHS Board of Directors